RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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April 13, 1994 **LETTER 1145**

Mar. 31 DJIA 3635.67; PTI 4052; A-D Ratio -5.13
Apr. 8 DJIA 3674.26; PTI 4048; A-D Ratio -4.99
Dow Yield: 2.78%; Dow Price/Earnings: 25.2
Dow 200-day MA: 3701; Dow 30-day MA: 3792
Dow Times Book Value: 3.20; PTI 89-day MA: 4056
Percentage of Undervalued Blue-chips: 9%
Dow Low Risk Buy Index: +135; Gold-PTI: 988
Gold 40-week MA: 379

EARLY THOUGHTS: The function of the stock market is to discount, to look ahead. What the current market sees, it doesn't like. The market is telling us in its own way that difficult times lie ahead.

The stock market action feels "heavy," and it's obvious that the mutual funds, the closed-end funds, the hedge funds and the public are stuck ("loaded") with billions of shares of stock. ***In a bear market values deteriorate through time.*** To put it another way, the longer you hold stocks during a bear market, the greater the odds that you will be dealing with losses.

News travels a good deal faster today than it did when I first started in this business. Therefore, the perception (on the part of the public and professionals) that "this is a primary bear market" should gain rapid acceptance. The result -- US consumers will become frightened. When they do, they will cut back on their spending.

Remember, consumer spending accounts for two-thirds of the US Gross Domestic Product (GDP). If consumers become frightened and slam the brakes on their buying, we could have a real shocker -- the shocker would be the US economy sinking back into recession.

A second potential shocker -- a recession would trigger a dramatic drop-off in tax receipts to the government. Shrinking tax receipts in turn would mean sharply rising federal deficits and a declining dollar. The single island of safety would then be -- gold.

THE MARKET: The April 1 Special Report stated flatly that we are now in a primary bear market. This stance was based on my interpretation of Dow Theory, plus the negative action of my Primary Trend Index as it finally broke below its 89-day moving average.

It's always difficult to make a pronouncement regarding a turn in the tide, and most analysts are understandably reluctant to put such pronouncement in writing (particularly if the tide is changing from bull to bear).

I don't see it that way. I feel my subscribers have paid their hard-earned money to hear what I have to say, and if I censor my true thoughts or if I hold back for fear of being wrong, then I have short-changed my readers.

Sure I could be wrong, sure I could be reading the Averages incorrectly. Yes, my PTI might finally be malfunctioning. If it turns out that I'm wrong, believe me, you'll know it, and I'll admit it. But what good is a market letter that simply follows the consensus while making every effort to play it safe?

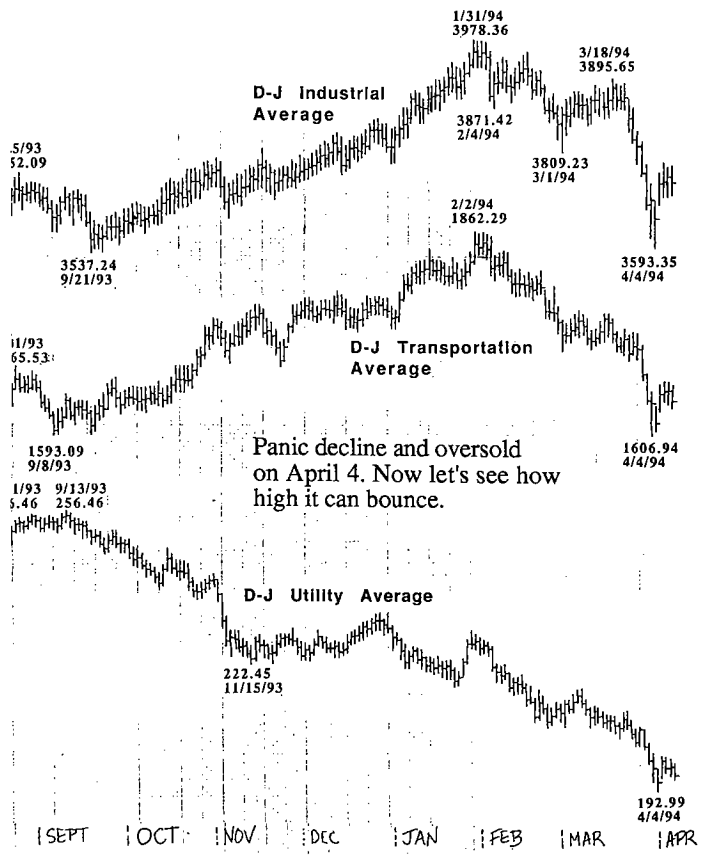
If you read the newspapers or listen to the radio or watch CNBC you'll note that the current conventional wisdom states, "Yes, we can have a 10% or 15% correction, in fact we need one -- a correction is long overdue." Since the Dow has already dropped substantially, this is a safe and obvious follow-the-leader opinion. And if you're a house economist and you work for a Wall Street firm, that kind of guarded opinion won't get you fired.

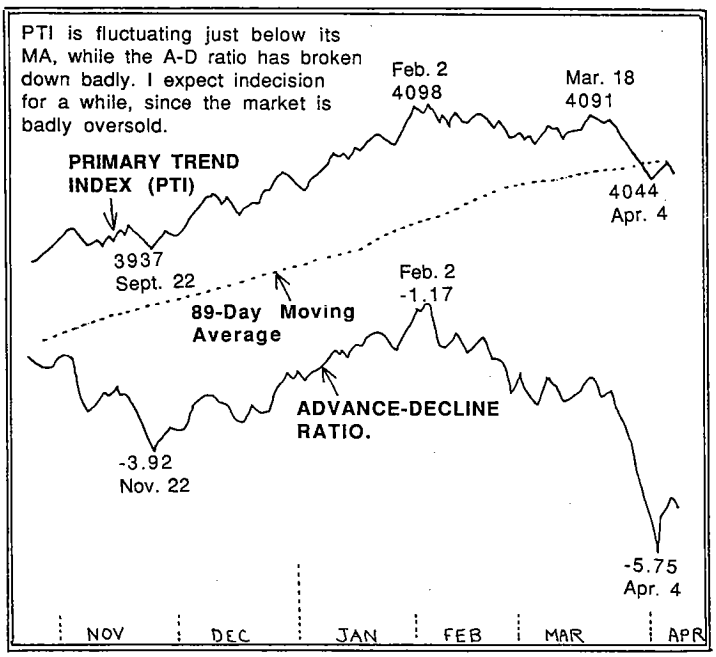
However, my stance is different. I believe that this is a primary bear market, but that it's impossible to predict the exact duration or extent of the coming decline. Each bull and bear market is a law unto itself. For instance, how many of us in 1974 (Dow at 577) foresaw a bull market that would extend to 1994 and advance the Dow to just a shade under 4000? How many in 1937 saw the Dow being cut in half by 1938? How many in 1929 saw the Dow heading down in a disastrous wipeout of 89% of its value? How many of us in mid-1949 foresaw that the Dow, then at 161, would advance for the next 17 years to a high of 995?

The answer, as I said, is that each bull market and each bear market is a law unto itself. And while we can't predict the extent or duration of a primary move, we can, at least, hope to IDENTIFY the turns when they occur.

As the bear market progresses, we can expect all sorts of hopeful or even optimistic predictions (and excuses) from "name analysts." Wall Street doesn't make money during a bear market, so bearish comments will be muffled or repressed, while every effort will be made to "accent the positive."

Opinion, predictions, forecasts -- the bear couldn't care less. I've said this many times before, but I want to repeat it. In a bull market it's the bull's desire to advance the market as far as he can while taking as few investors as possible with him. The opposite holds true in a bear market. In a bear market the bear wants to take the





market down as far as he can while taking as many stockholders with him as possible.

The bear plays a nasty game, and, unfortunately, he has no conscience. The bear's fondest wish is to separate the investor from his assets, and he'll do anything he can to gain his ends. How does he do it? He has his ways -- rotten news and nasty events. News of bankruptcies, a sudden drop in earnings, omitted dividends, lay-offs, corporate thievery, an international incident, a presidential gaffe, if it's negative the bear will find it and use it.

Let me put it this way -- in a primary bull market everything somehow seems to work out for the best. Nations sign peace treaties, Chapter 11s are settled out of court, mergers work out, dividends are raised, presidential miscalculations are glossed over. In a bear market nothing seems to work out right -- wars start, corporate officers abscond with assets, dividends are omitted, companies go belly up, revered Washington figures turn out to be crooks, shocking news emerges on all sides -- well, you get the idea.

This may sound outlandish, but I believe that the arrival of Bill Clinton as president is no accident. Clinton is my candidate for the perfect bear market president. He's devious, he's slick, he's a hypocrite, he's a vacillator and a compromiser, he's an advocate of BIG government, he's full of surprises, and most of his surprises turn out to be decidedly unpleasant.

PRICE ACTION: On April 4, after many days of extreme decline, we had lows of **3593.35** for the D-J Industrials, **1606.94** for the Transports. These lows were accompanied by the most acute oversold condition of which I have any record (the McClellan Oscillator plunged to a record minus 273). My bond Oscillator also hit the most massive oversold in my records. From the April 4 lows, both stocks and bonds rallied. My PTI will be the best gauge of the strength of the rally (see Late Notes for more).

THEORY: How do we know when we receive a Dow Theory bear signal that a bear market will actually follow? The answer is that we don't KNOW a bear market will follow -- we rely on previous case histories. When a surgeon performs a serious operation, how does he know that the patient will recover? The answer is he doesn't. He relies on his own experience and on previous case histories.

Charles Dow (writing around the turn of the century) was a superb observer of markets. Dow's single most important observation was that cycles exist (or long term trends) in the stock market and in human sentiment. The cycles run from extreme optimism (bull market peak) to extreme pessimism (bear market bottom), and then back to extreme optimism again. That simple but critical observation forms the basis for the entire thesis of primary bull and bear markets.

The hard part is identifying the extreme areas, the areas from which primary reversals occur. This is where knowledge of phases comes in, this is where Dow Theory signals come in, this is where the test of values comes in, this is where an appraisal of investors' sentiment comes in.

Question: Why, once the market turns down from extreme optimism (bull market top), does the cycle have to go all the way to extreme pessimism? Why, for instance, can't the market go from extreme optimism to less optimism, back to extreme optimism? Or why can't the market just remain in a generally optimistic area for decades?

Answer: It can. There is no absolute regarding the primary trend; all we have to go on are case histories. We know that following big bull markets of the past we have always had big bear markets. There's never been a bull market that has not been corrected. True, some corrections (bear markets) are horrendous, others are less so.

We also know (from case histories) that all major bear markets have wiped out at least half of the preceding bull market's gains.

Therefore, I take the odds as extremely high that since this bull market has topped out (and I believe it has), we will experience a costly bear market. How costly? I don't know. How will the bear market proceed? I don't know. How long will it take? I don't know. (But in the next Letter I will at least provide educated guesses.)

In summing up, I believe that the bull forces have seen their best. I believe the cycle is now in the process of changing from bull to bear. I believe the bear market will take quite a long time to complete. I believe the final bear market lows will be surprisingly low, lower than most people want to think about. I believe the path down will be treacherous, difficult, and costly. In the next Letter I will outline some potential downside targets for the market (and I can tell you now that the projections will not make for pleasant reading).

INVESTMENT POSITION: I've put the bear in the box. He may be a bit weak and wobbly now (he's been sleeping for many years, but he'll gather strength as time goes by).

As to what action to take, I follow what I term correct investment procedure. Correct procedure tells us to load up in a newly confirmed bull market. Correct procedure also tells us to move to the sidelines during a newly confirmed bear market.

Listen, if I knew for certain that the bear market would halt at Dow 3500, I'd write, "If you haven't sold by now, well, you might as well just hold your stocks and sit tight." If I knew for certain that the Dow was heading for 1500 by 1996, I'd write, "Sell everything down to the last share." Honestly, I don't know how bad this bear market is fated to be. So all I can do is outline correct procedure. I outlined it above. Please mull it over.

In a newly confirmed bull market you can buy a little stock or buy a lot of stock. If it's a minor bull market, so what, you'll only make a little. If it's a big bull market you'll make a lot. But either way, the worst you will do is gain something.

A bear market entails much tougher decisions. In a newly confirmed bear market you can sell a little or you can sell everything. If it's a sub-normal bear market you may only lose a little. If it's a major bear market you'll lose a lot. But either way you will lose something. Me, I'm out of common stocks.

As for gold and gold stocks, we're again going through a baptism of fire. Every time gold pushes into the 385-390 area, it's knocked down. The Fed, above all, does not want gold above 400. I guess the best way to view gold is that it's in a broad trading or consolidation range. The range appears to be 370 to 390.

"THREE STRIKES AND . . .": This Dow chart was drawn by John "Mr. Computer" Carder. The chart is a semi-log rendering of the Dow going back to 1982. I don't believe many market practitioners (and I'm including professionals) realize what is implied here.

I have drawn three rising trendlines, each starting from the 1982 Dow low of 776.92 (that was the August 12, 1982, Dow closing low). Trendline #1 was violated during the market crash of 1987. The second trendline connects the 1982 low and the 1987 crash low. That trendline was violated during the mini-crash of 1990.

Then we have the third trendline, a trendline connecting the 1982 and the 1990 lows. That third trendline was violated in late-March as the Dow collapsed off its 1994 high.

The violation of three successive rising trendlines has never been a good technical omen where the stock market is concerned. A popular expression today is "Three Strikes and You're Out." I think there's a good chance we can apply that expression to the stock market.

Another thought: a semi-log chart deals in percentages. For instance, on a semi-log chart a rise from 45 to 90 (which is a 100% rise) would take up the same vertical distance on the chart as a rise from 800 to 1600 (also a 100% rise). Since in the investment business we deal with percentages, semi-log charts assume great importance.

One thing that shows up with striking clarity on this chart is that the decline from the 1994 all-time peak in the Dow (3978.36 on January 31) has been so minimal in terms of percentages (to put it another way, this is why the decline, so far, looks so minor on the chart).

Let me give you an interesting concept. If the Dow was to be cut in half from its extreme high, that would take it down to just below 2000. Yet pick out the 2000 level on this chart. A decline to 2000 does not look that impossible, or, for that matter, that bad. Yet a decline to Dow 2000 would play absolute havoc with the typical stock portfolio.

It all boils down to this -- when the primary trend of the market turns bearish, there is absolutely no way of telling how far the bear market will carry. Many amateur analysts talk about "support levels" in a bear market, little realizing that a characteristic of primary bear markets is that they slice through widely-recognized "support levels."

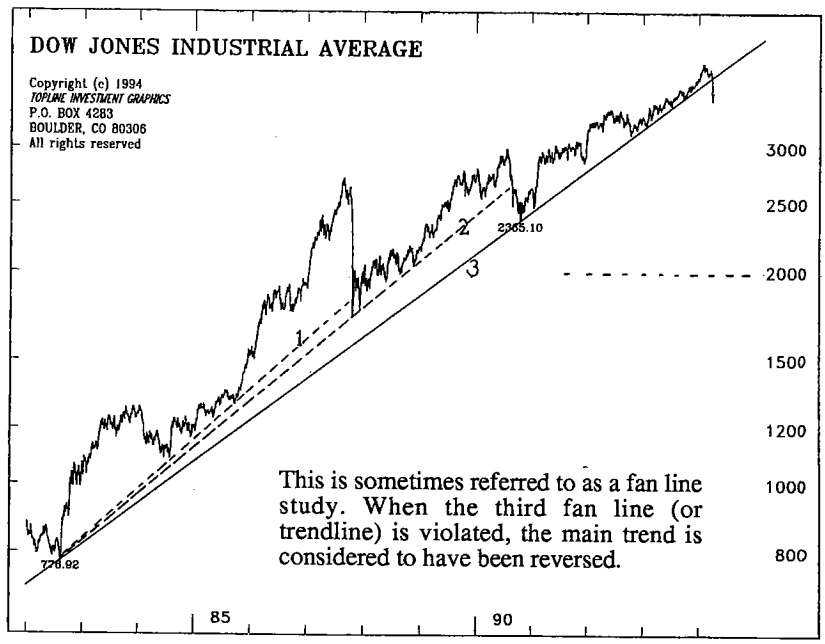
There are many opinions and arguments about where the great bull market started. I have always held that the bull market started in late-1974 at 577.60 on the Dow. If that's the case, then the Dow added 3400 points during the life of the bull market. I've noted many times in the past that most true primary bear markets tend to wipe out at least half of the preceding bull markets' gains. If that's what's fated to occur during the course of this bear market, then we could expect the Dow to decline to at least 2278.

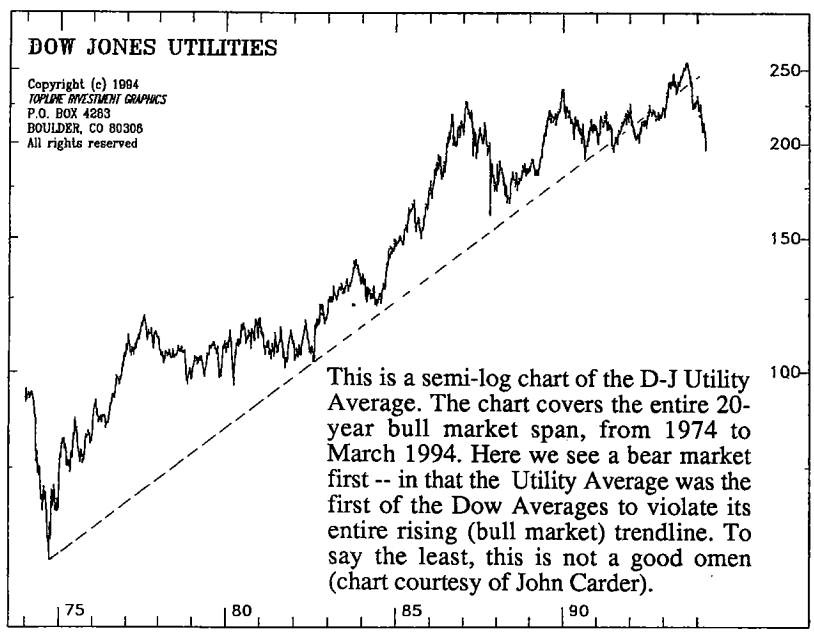
Will that happen? There's no way of knowing. Remember, this is a business of probabilities, not certainties.

The Fed has been blamed for "triggering" this bear market when it twice raised the Fed Funds rate. In my opinion, it's ridiculous to blame the Fed for the bear market. However, we know (1) that the Fed is a determined enemy of gold, and (2) that the last thing the Fed wants is a primary bear market in stocks with a potential collapse of the economy. Therefore, there is talk of the Fed moving to "stabilize" both the stock and bond markets by buying derivatives. Is there any truth to the rumor? I have no idea.

I do know this. If we're in a true primary bear market the Fed will have as much chance "holding the markets up" as it did holding the bond market up over the last few weeks. The Fed can add steam to a bull market (which would mean stimulating the already established primary bull trend), but it can't reverse a bear market. Nobody can. A bear market, one way or another, will go to conclusion, and manipulation will only prolong the life of the bear.

POWER, CONTROL: I've long believed that two of the strongest and most destructive urges of mankind are the urges (compulsions) for power and control. Why do some people want to be politicians, why do some men want to be dictators, why do some men become serial killers, why do others become heads of corporations? In all cases, there are elements of the drive for power and control.

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This is a semi-log chart of the D-J Utility Average. The chart covers the entire 20-year bull market span, from 1974 to March 1994. Here we see a bear market first -- in that the Utility Average was the first of the Dow Averages to violate its entire rising (bull market) trendline. To say the least, this is not a good omen (chart courtesy of John Carder).

What's behind the urge for power and control? Some say it is a feeling of inferiority, a feeling that, "I'm weak, and therefore I've got to cover up that frightening feeling by exerting power over other people."

In contrast, to the urge for power, why do most other people go along with the leaders who demand power and control? Why did populations numbering in the multi-millions go along with Saddam, Stalin, Hitler, Hirohito, Napoleon, Alexander? Just as some people crave power, others (most others, it seems) want or need a leader, a "great father" figure, someone they can identify with or admire or follow, follow even to their own deaths.

Strangely, I have not seen a lot written about the urge or the will to power. Maybe it's a subject that is too hot to handle. Maybe it's a subject so basic that psychiatrists don't feel it's worth the time to write about.

It's true, humanity needs leaders, if for no other reason than to oppose tyrants. One of America's greatest leaders was a man who understood the dangers of the urge for power. At the end of his presidency, Washington was offered a chance to be a sort of perpetual president or even an emperor. Washington turned it down, saying that two terms for a president were enough. I wonder whether any politicians today would follow Washington's example.

Alexander Hamilton, our first Treasury Secretary, understood the danger to the people of men who desire power, and he wrote, "Give all power to the many, and they will oppress the few. Give all power to the few and they will oppress the many. Both, therefore, ought to have power, that each may defend itself against the other." That's the thinking behind the Constitution; that's the thinking behind the US government's system of checks and balances.

The founding fathers wanted to protect the nation against those who demand power and control. And that protection is the true genius of the great US Constitution.

Throughout the years, there have been many attempts to get around the Constitution. I might add that of all the schemes to subvert the Constitution, in my opinion the most flagrant (and one they got away with) was the creation of the Federal Reserve and its issue -- fiat or non-gold backed money. Both the Federal Reserve and "paper money" are directly against the expressed desires of the men who drew up the Constitution.

Speaking of the Constitution, there are now six amendments to the Constitution that are working their way through the House and Senate (aside from the Balanced Budget Amendment, which has just been defeated). The six amendments would mandate a line-item veto, disallow retroactive taxes, prohibit unfunded federal mandates, limit Congressional terms to 12 years or to six, guarantee equal rights for women, and make the District of Columbia a state. Of the six, I would guess the DC one would be most likely to pass.

Personally, I would like to see all six pass, if not via Constitutional amendment, at least through Congressional legislation. As for retroactive taxes, as you know, I feel that Clinton's current retroactive tax is an outrage, and it s implications totally immoral. ("Hey, let's slap a surtax on all those who made $50,000 or more a year, and let's take it back to 1980".) The implications of the retroactive tax are evil. Clinton must know that.

NOTES & QUOTES: Inflation dead? Bill Gates, multi-billionaire CEO of Microsoft, will be paid $2.5 million by Penguin USA to write a book, presumably about computers . . . Meanwhile Norman Braman will sell the football Philadelphia Eagles to Hollywood producer Jeffrey Lurie for a record-breaking $185 million. Norman bought the Eagles in '85 for $65 million (that's an increase of 184%).

* *

The Fed's got to be in a quandary. The current word is that "the Fed will boost the discount rate once the market settles down." But if the bear takes hold and things start to fall apart in the market and the economy, the Fed will be afraid to boost rates. They'll actually be tempted to drop rates, but they can't because that would mean a loss of face; it would mean they were wrong in the first place. Greenspan should have retired (as a hero) in February.

* *

"Bear talk" has quickly burst forth in the media. For instance, *Newsweek* quoted me and discussed my PTI (Jane Bryant Quinn's column) in its April 11 issue, and on the cover they featured a huge snarling bear.

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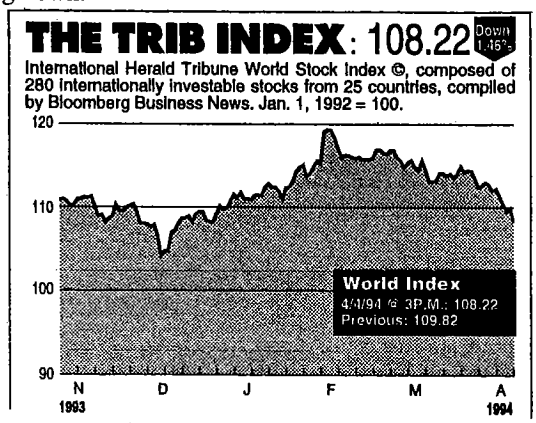
The bear market is international in scope. This chart (from the *International Herald Tribune*) shows the trend of 280 major international stocks. The peak was recorded in January. They are heading down.



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Canada has been very bad, it has run up endless large budget deficits, and it has sold almost all of its gold. The Canadian dollar reflects the situation. The Canadian dollar is now within two cents of its all-time low (in US dollars) of 69.5 cents. All eyes are watching to see if Canada's dollar can avoid making new record lows.

* *

According to *Reuters,* the Russian economy has reached the catastrophe stage; for February Industrial output dropped a record 27.1% compared with the same month last year . . . Meanwhile, the world is watching the explosive situation in S. Africa where elections are scheduled for late-April. Russia and S. Africa are both major producers of gold.

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How good is Greenspan at predicting the trend of the economy? We'll find out, won't we. At last count, Greenspan was quite optimistic. But this is a bear market, and I'm betting that Greenspan is going to be very wrong.

Fed's Greenspan Sees Bright Future For Nation's Economy

By JAMES H. RUBIN
Associated Press Writer

WASHINGTON — The future of the U.S. economy is brighter than many Americans apparently believe, Federal Reserve Board Chairman Alan Greenspan said Friday.

technological advances and financial innovations ... create frictions and human stress," he said. "As those frictions dissipate, however, I have no doubt that the economy will emerge healthier."

Greenspan did not address the current state of the economy in his

* *

Wall Street often (but not always) has a good feel for what's coming up in the markets (remember, Wall Street makes money during a bull market, not during a bear market). For the above reason, I selected Merrill as the best single-stock barometer or proxy for the entire stock market (in the old days the accepted single stock barometer was US Steel, later it was General Motors).

Another place I watch is the price of a seat on the NYSE. Seat prices tend to go up or down with volume, but as a general rule during a bull market seat prices will rise and during a bear market they will decline. Latest action: on March 17 a NYSE seat sold for

$830,000, up $80,000 from the previous sale. The current bid-asked price for a seat is $760,000 bid, $1 million asked. It will be interesting to see what the next seat sells for.

I remember back in 1949 when the father of my old friend Wayne Marcus (Marcus & Co.) bought a NYSE seat for $70,000, I was amazed at the fat price he had to pay for a seat. But times change, inflation eroded the dollar, and today that $70,000 price appears ridiculously cheap.

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Charles Biderman of *Market Trim Tabs* notes that stock and bonds now equal 41% of household assets vs. a 21% low in 1974 and a previous peak of 38% in 1968.

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Say It Isn't So Dept: Saturn, the hope of GM, the much-touted GM experimental car, isn't doing so well. Why, what happened? Well, Saturn comes in only one size -- small. And as one writer described it, "Saturn -- the innovative import-fighter and redeemer of GM -- has become just another pretty good small car with outdated styling and a relative handful of dealers." Result: GM is cutting back sharply on production of Saturns as it tries to mop up its current swollen inventory. In the meantime, Chrysler is coming out with its new small car, Neon, and both Chevrolet and Pontiac will launch newly designed small cars.

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Gambling: No less than 10 additional states are seriously considering legalizing gambling. The states are Mass., Rhode Island, New York, W. Virginia, Penn., S. Carolina, Kansas, Ohio, Ala., Fla. The states are losing potential tax revenue to Indian gambling and to neighboring states that have legalized gambling. Gambling, it may soon be known as "the Indian's revenge." Question -- how long will California (which is deeply in debt) be able to resist the clarion call of legalized gambling?

* *

Life in the West: A new California law states that if you buy a handgun, you have to take a safety course. That has hardly stopped California gun-buyers who have set records recently in the number of handguns purchased. For you subscribers who live in restricted states or cities where honest people are not allowed to buy or even own a handgun, this is a typical ad that I clipped from one of our local papers. As for burglars, let it be known that when you break into a San Diego home, the odds are better than even that you'll be confronted by an angry armed citizen.

CZECH CZ52
These pistols are a must for any collection. 7.62 cal, 8 shot magazine. Holster, spare magazine.
Only $149.99
Russian Makarov
Made in Russia, double action, with holster & spare magazine, 8 shot, 9x18mm caliber
Only $149.99
Beretta Mod 92F 9mm
The same reliable model that the U.S. Military uses. 15 shot, double action, case, spare magazine.
Sale $499.99
USED GUN SALE
DISCOUNT GUN MART
1510 MORENA BLVD.
SAN DIEGO

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CD-ROM (which puts a carload of information on a single disk) is sweeping the nation. Here are a few items that I've recently seen advertised for CD-ROM. For $89.95 you can get the entire text of the 29-volume Funk & Wagnalls New Encyclopedia combined with seven hours of sound and thousands of images, animations and maps (Microsoft Encarta). Here's another, for $54.95 you get the 1994 edition of Movie Guide containing thousands of reviews by Maltin, Ebert, Kael, including biographies of 4,000 movie personalities (Microsoft Cinemania '94). And I ask myself, how can they make money at these prices? Probable answer -- updates. The information business, it's in the process of exploding.

Russell comment: The need for entertainment products (even as TV channels multiply) is going to be huge. The problem will be to make money on these products, since the competition will be intense. Item -- Disney next year will produce roughly one-third of all major films.

* *

This from a letter received last week from famed author Arthur Hailey (the author lives in the Bahamas). Quoth Arthur: "Richard, just in case you are not familiar with this, Canada (like Britain) taxes on the basis of domicile, not citizenship. Therefore Canadians can live in a tax haven and legitimately not pay taxes . . . This is in contrast with the US, which is the only major country in the world which taxes on the basis of citizenship." Russell comment: If you are an US citizen, no matter where you live, the US will tax you (although the first $70,000 of foreign earnings are exempt from US taxes). As for the Bahamas, it imposes no personal or corporate levies, no estate duties, no sales or capital gains taxes. In other words, what you earn is what you keep.

* *

By now readers must know that I can't stand the Clintons, either of them. Clinton repeatedly denounced the Reagan-Bush "gilded age of greed and selfishness," but the more we know about the Clintons, the more we realize that they did everything in the books to grab money during the Reagan-Bush era (I won't even comment about Hillary's suspicious killing in commodities).

One plus that has come out of all the investigations is that Clinton's image and credibility have been badly damaged, and this will make it much harder for him to pass any of his socialistic legislation. One plus for the bear market is that it increases the odds tremendously that Clinton will be a one-term president.

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Spam: Hormel brought out Spam in 1936, and World War II vets know Span well. Hormel just announced that they sold their five billionth can of Spam. What is it? It's pure pork shoulder mixed with spices and salt and packed in aluminum cans. Confession: I ate my fill of Spam during the war, and I liked it. Spam lasts forever in the can, and a 30-year old can of Spam was just eaten by some testers, who pronounced it "good." Khrushchev wrote that Spam saved the Russian army from starving one winter during WWII.

* *

Speaking of food, how important is a restaurant review from the *NY Times*? Very. Lespionasse in the St. Regis Hotel just got a four-star (a very rare top rating) review from *Times* reviewer, Ruth Reichl, a recent transfer from the *LA Times*. What happened? The restaurant is booked up for weeks ahead, and the last I heard you might possibly get a reservation in May. The 39-year-old chef, Gray Kunz, wasn't entirely happy with the advanced bookings. Said he, "When people start booking three months in advance, they forget their reservations and don't show up." Russell comment: I only miss two things about NYC, the museums and the food. But if this bear market continues, my guess is that the wait for reservations at top NY restaurants will be much less of a problem.

* *

My old friend, Chick Goslin, has published a very valuable 50-page booklet on commodity trading. Chick is a terrific trader, and he knows his way around commodities as few people do. The booklet is entitled, "How To Be An Intelligent Futures Trader (using momentum trading)." The booklet is chock full of wisdom, trading advice, charts and information. Price $50, Chick Goslin, PO Box 2363, La Jolla, CA 92038. As usual, I suggest only literature which I believe in, and I take no commission or anything else on a sale.

* *

Paula, my ex-wife, and her husband took my two youngest kids (Lauren and Ryan) skiing at Bend, Oregon. They went with their friend, Sam Goldwyn, Jr., and his boy Peter. Paula called last week, and I asked her how it was going. "Lauren broke her ankle," she said. "Anything else?", I asked. "Yes," she answered, "Peter came down with scarlet fever." I gulped, "Well, try and get Ryan back whole."

* *

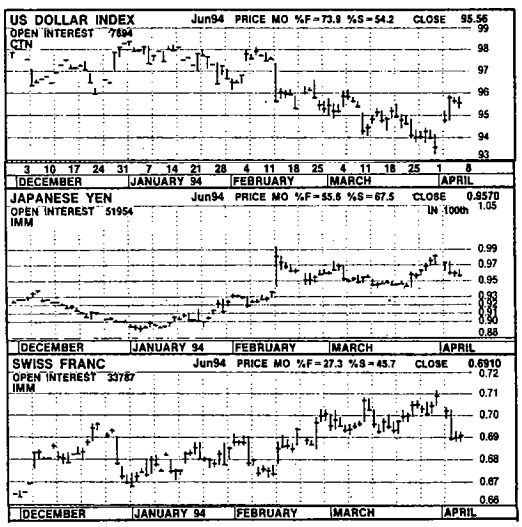
Ed Hyman, Wall Street's favorite economist, has been bullish or at least optimistic for quite a while. But his latest report includes an interesting section. (Does Ed smell the breath of the bear? He does read my Letters.) Ed writes: "The case for a slowdown: A lot of today's economic momentum was generated by last year's decline in bond yields and related surge in stock prices and mortgage refinancing activity. Now, yields are up sharply, stocks are down a sobering -10%, and refinancing activity has declined -75%. In addition, heavier tax payments are due in two weeks and MZM (M3 plus mutual funds) growth has slowed from 10% to 3%. Of lesser importance, but still of significance, the consumer savings rate is low, debt to income ratios are high, layoffs are widespread,

defense spending is contracting, state & local governments are still pursuing budget deficit reducing policies, and overall, the other G7 countries are still experiencing soft economic performance."

* *

The rise in US rates has strengthened the dollar. These charts from *Investor's Business Daily* will update you on the currencies (which I follow very closely). Most recently the dollar has gapped up, and I think we have seen the dollar's low for a while. Of course, the Japanese would love to see a higher dollar and a lower yen, since that helps Japan's exports.

Finally, the Swiss franc has broken down below its March lows, and I feel that the Swissie is simply in a trading range. The Swiss franc is the world's most stable currency for a number of reasons. (1) The Swiss stay out of wars. (2) The Swiss are a conservative people. (3) The Swiss banks are still a major repository for foreign money. (4) And last but certainly not least, the Swiss franc is backed 40% by gold, and its gold is valued at $42.22 an ounce, which means that at the market price the Swiss franc is backed by over 100% gold (Canada, and the US, are you listening?).


US DOLLAR INDEX Jun94 PRICE MO %F=73.8 %S=54.2 CLOSE 95.56
OPEN INTEREST 7694
CTN
DECEMBER JANUARY 94 FEBRUARY MARCH APRIL
JAPANESE YEN Jun94 PRICE MO %F=55.6 %S=67.5 CLOSE 0.9570
OPEN INTEREST 51954
IN 100th
IMM
DECEMBER JANUARY 94 FEBRUARY MARCH APRIL
SWISS FRANC Jun94 PRICE MO %F=27.3 %S=45.7 CLOSE 0.6910
OPEN INTEREST 33787
IMM
DECEMBER JANUARY 94 FEBRUARY MARCH APRIL

GOLD: You may remember that in an early January Letter I wrote that 1994 would be the year of surprises. So far, that "prediction" hasn't been too far off the mark -- and guys and gals, we've got a long way to go.

As this bear market in stocks progresses, losses will mount. The bear market losses are going to create fear. Therefore, my guess is that by mid-year (maybe before) the US economy is going to turn (surprisingly) down. With Congressional elections coming up and with a President who has garnered only 40% of the votes, Washington will panic, and the pressure will be on for the Fed to pump.

The Fed will want a return to lower interest rates, and they will want to make money as easy and as available as possible. In other words, the Fed will move (even more forcefully than before) to REFLATE.

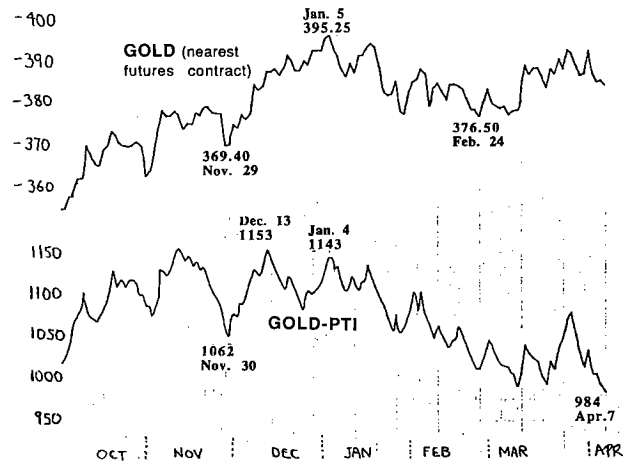
The Fed's anti-recessionary policy will cast doubts on the viability of the dollar and there will be a decline in the dollar's purchasing power. When the value of the dollar starts declining, investors (both domestic and foreign) will protect themselves by buying gold.

As for buying and holding gold and gold shares, nobody ever said it would be easy, especially at this early stage of the game. Let's turn to *Chartcraft's* point & figure chart of gold. Each box on the chart equals four dollars and only rallies and declines of 12 points or more are depicted.

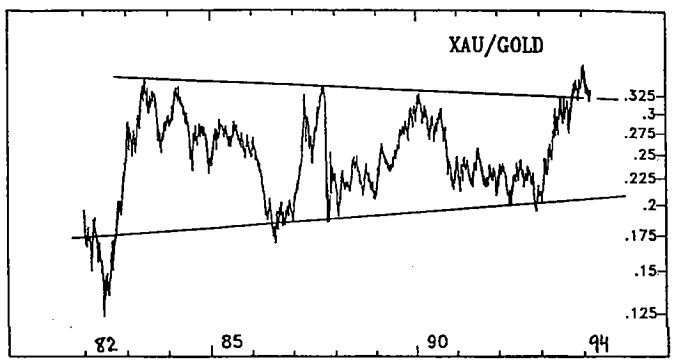
In March '93 gold broke above declining trendline A, and all the action since then has taken place above rising trendline B. As long as gold respects trendline B, the overall trend must be considered as bullish. An upside breakout would come at **396,** while a minor breakdown would occur at **376.** As I see it, gold is simply backing and filling here within the context of an established bull trend.

London Gold
PM Fix Only
A
B
LONDON GOLD- Chart remained at the $388 level, and cash prices closed about $1 higher. The next potential Buy level is $396. Resistance at $400 has not been overcome on rally and that is a key area in the longer term picture.

Turning to the second chart, we see the Gold-PTI sinking to a new low for the move. However, gold has refused to confirm, and the metal is holding well above both its November and February lows. The G-PTI has been declining for four successive months, and it should be quite oversold by now.



The third chart (by John Carder) depicts a ratio, XAU (the gold stock average) divided by gold. As you can see, the stocks got too far ahead of the metal, which is basically the problem with the gold stocks now. The stocks need the metal to advance before the stocks will advance. My intuition tells me, by the way, that this ratio will



tend to remain high, in that the stocks will tend to remain high-priced in terms of the metal (remember, the gold stocks have upside leverage when gold rises).

LATE NOTES: 3593.35 (Industrials) and **1606.94** (Transports) are the 1994 lows recorded on April 4. Continuation of the bear market will be signaled by a joint breaking of those lows. But don't be surprised by erratic and confusing action for a while; the bear is in no hurry . . . The Fed is apparently traumatized; it's now expanding its balance sheet at the furious annualized rate of 16.1%. (This, despite the perception that the Fed is tightening!) In the meantime, gold is playing the "water torture" game.

NEXT MAILING: April 27, 1994